

STATE OF NORTH DAKOTA
BEFORE THE COMMISSIONER OF INSURANCE

In the Matter of the Application of)	RECOMMENDED
Surety Mutual Life and Casualty)	FINDINGS OF FACT,
Insurance Company)	CONCLUSIONS OF LAW,
		AND ORDER
		CASE NO. CO-03-126

On November 12, 2003, Surety Mutual Life and Casualty Insurance Company (“Surety Mutual” or “Company”) filed a Plan of Conversion with the Insurance Commissioner, seeking to demutualize and convert from a mutual company to a stock company. The proposed conversion is governed by N.D. Cent. Code § 26.1-12-32 and N.D. Admin. Code Chapter 45-03-21.

Also, on November 12, 2003, Surety Mutual filed a Special Board Resolution approving the demutualization plan, a Plan of Operation, Three Year Pro Forma financial projection, a proposed Notice to Members, proposed amended Articles of Incorporation and proposed amended By-Laws.

Notice of the proposed conversion and a pending hearing was published in five daily newspapers within North Dakota as required by law. The Notice was also mailed to all eligible members of Surety Mutual.

The Commissioner scheduled a hearing on the proposed conversion for January 20, 2004, at 1:00 p.m. in the Red River Room at the State Capitol, Bismarck, North Dakota.

The hearing was held at the above time and place. Deputy Commissioner Douglas Holloway presided as hearing examiner. Surety Mutual was represented by attorney Greg Morris of Ellison Law Office, P.C. Surety Mutual witnesses included Duane Steffes, President

and CEO of Surety Mutual; Ernie Frankovich, Actuary; Steven K. Johnson, Certified Public Accountant; and Sharon Berg, Secretary of Surety Mutual. Lance Mayhew, Surety Mutual Vice President, was also present. The Insurance Department was represented by Charles E. Johnson, General Counsel, and Tim Hill, Financial Analyst. Craig Burns, Insurance Department Legal Counsel, was also present.

RECOMMENDED FINDINGS OF FACT

Based upon the testimony presented at the hearing and the other documents of record, Deputy Commissioner Holloway makes the following Recommended Findings of Fact:

1. Surety Mutual is a very small life and accident and health insurance company.
2. Surety Mutual started writing business on June 10, 1936, selling A&H policies with and without the Contingent Premium Refund Benefit. There were 120 A&H policies in force on December 31, 2002, without the Contingent Premium Refund Benefit. There were 3,474 A&H policies in force on December 31, 2002, with Contingent Premium Refund Benefit.
3. From 1983 through 1993, Surety Mutual sold a whole life insurance policy with a reduced benefit during the first three policy years. There were 65 individual life policies in force on December 31, 2002, that were paying premiums. There were four group life certificate holders in force on December 31, 2002.
4. Surety Mutual proposes to convert from a mutual company to a stock company to meet the changing needs in the insurance industry and better allow it to compete in today's marketplace.
5. Demutualization will allow Surety Mutual enhanced access to capital and improve Surety Mutual's economies of scale, allow it a better opportunity to gain access to additional products and product development resources, provide it with an opportunity to grow core

businesses and gain access to a larger distribution system for its products, allow it to expand its market into other states, and provide it with enhance financial security associated with a larger capital base.

6. The conversion will allow Surety Mutual the flexibility to raise funds rapidly, thereby providing for greater future growth and expanded operations that might otherwise not be available.

7. For a number of years Surety Mutual has suffered operating losses, resulting in reductions in surplus and posing an imminent threat to the solvency of the company.

8. Upon conversion, Duane Steffes will purchase 500,000 shares of stock for \$500,000. He will also contribute a total of \$700,000 to surplus, of which \$50,000 was contributed in the form of a surplus note on September 29, 2003, with the remainder to be contributed to surplus upon the approval of the proposed conversion. Mr. Steffes' total contribution to the company will be \$1.2 million.

9. Every policy that is in force shall continue as a policy of the converted Surety Mutual and all contract rights of all policies will be as they existed immediately prior to the record date.

10. All eligible members shall receive cash as consideration for relinquishing their voting rights. Eligible members include those with a policy in effect at any time during the one-year period prior to October 1, 2003, the record date.

11. The amount of cash received will be determined by applying a formula developed by Mr. Frankovich, Surety Mutual's actuary.

12. Each policyholder will receive \$5 for the policyholder's voting rights.

13. Each policy, whether or not it contains the contingent premium benefit, will receive from \$0 to \$56 depending upon the annualized premium for the non-contingent benefits and the number of years in force. Thirty percent (30%) of the surplus remaining after the distribution of \$5 per policyholder will be distributed to this class of policyholder.

14. Each policy containing the contingent premium benefit will receive from \$0 to \$163 depending on the amount of the contingent premium benefit on March 31, 2004. Seventy percent (70%) of the surplus remaining after the distribution of the \$5 per policyholder will be distributed to this class of policyholder.

15. The above distribution amounts assume a surplus of \$50,000 which may be more or less and will reflect the company surplus as of April 1, 2004.

16. Mr. Frankovich testified that the proposed distribution is fair in that it reflects the rights of the policyholders and the contributions to surplus without penalizing individual policyholders for past claims.

17. Surety Mutual's surplus is small because of past operating losses.

18. Surety Mutual's surplus will continue to shrink unless the proposed plan of reorganization is approved, thereby jeopardizing the continued viability of Surety Mutual.

19. The company's lack of capital and the inability of the company as a small mutual company to raise capital placed the company at a competitive disadvantage in the industry.

20. Surety Mutual cannot grow its business rapidly enough to provide cost effective products and services without additional surplus.

21. Surety Mutual's Board of Directors considered alternatives to demutualization, including remaining as a mutual company, reorganizing as part of a mutual holding company,

and merging with another mutual company, but none of these alternative were found to be feasible.

22. Even though the cost of the reorganization as of January 20, 2004, was approximately \$40,000, with additional costs to be incurred, the Board of Directors and Surety Mutual management agree that demutualizing is the company's best alternative.

23. At present, Surety Mutual's marketing force consists of approximately 26 agents associated with Professional Insurance Services, an agency founded and owned by Duane Steffes.

24. Upon approval of the plan of reorganization, Surety Mutual proposes to expand its marketing effort by adding two additional marketing insurance agencies. It also intends to expand its operation into South Dakota.

25. For the present, Duane Steffes, President and CEO, will continue to oversee the day-to-day operations of the company, assisted by Lance Mayhew and Sharon Berg.

26. Surety Mutual will maintain the present administration and support staff and does not anticipate the need to hire additional support staff to handle the projected increase in business.

27. Surety Mutual's goal for the next three years is to increase sales by approximately 20 to 30 percent per year, which is reasonable considering the small size of the company's present sales.

28. The company will become profitable and be able to grow its surplus if it achieves its sales goals.

29. The reorganization will have no impact on existing policies. Current policies will remain in force with no change.

30. Steven Johnson, Surety Mutual's accountant, testified that there will be no adverse income tax consequences for the company or the policyholders as a result of the reorganization. The cash distribution to the policyholders will be treated as long-term capital gain.

31. Steven Johnson also testified that the company may lose some, if not all, of a tax loss carry forward of approximately \$140,000, but noted that notwithstanding the loss, the reorganization was essential because the shrinking company surplus will most likely force the company into liquidation.

32. Ernie Frankovich testified that the reorganization and the influx of \$1.2 million into the company is vital to the continued existence of the company.

33. Witness Tim Hill testified to the following:

34. That the proposed plan of conversion is fair, reasonable and equitable for the company and its eligible members.

35. That after demutualization, Surety Mutual should be able to satisfy all requirements for the issuance of a certificate for authority to write the lines of insurance for which it was licensed before demutualization.

36. That after demutualization, Surety Mutual will have sufficient capital and surplus to satisfy capital and surplus laws for a North Dakota domestic stock insurance company.

37. That the rights for every member, excluding voting and dividend rights, if any, will not be adversely affected by the demutualization.

38. That every policy currently in force will remain and continue in force with the terms of the policy.

39. That the financial condition of Surety Mutual after the demutualization should be such as to not jeopardize the financial stability or prejudice the interests of its policyholders and members and that after demutualization, Surety Mutual should be in a much stronger financial condition with the additional capital and surplus.

40. That Surety Mutual's management, even though inexperienced, will possess the necessary competence and integrity to reasonably manage the affairs of the company. Duane Steffes will continue as President, CEO and sole shareholder and will control the direction of the company.

41. That the demutualization of Surety Mutual will not be hazardous or prejudicial to the interests of the members, the insured, or the public.

42. That the proposed plan regarding the anticipated risks and benefits for Surety Mutual and its policyholders reasonably describe those risks and benefits.

43. That the additional capital generated from the demutualization and sale of stock is critical to the survival and growth of the company.

44. That the demutualization is in the best interest of the eligible members of Surety Mutual.

45. That the proposed business plan for Surety Mutual appears reasonable and attainable.

46. That the Commissioner should approve the proposed demutualization and the sale of stock to Duane Steffes.

47. No statement in opposition to the proposed demutualization has been filed with either Surety Mutual or the Commissioner and no one appeared at the hearing to testify in opposition to the proposed demutualization.

48. No director, officer, agent, or employee of Surety Mutual or any of its subsidiaries will receive any fee, commission, or other valuable consideration whatsoever, other than his or her usual salary and compensation, for in any manner aiding, promoting or assisting in connection with the transactions contemplated by the conversion.

RECOMMENDED CONCLUSIONS OF LAW

1. That the proposed plan is fair, reasonable and equitable to Surety Mutual, its members and its eligible members.

2. That the rights of every member in any policy of insurance of Surety Mutual, excluding voting and dividend rights, if any, will not be adversely affected by the demutualization.

3. That the influx of capital of \$1.2 million is vital to the continued existence of Surety Mutual.

4. That the reorganization and the contribution to capital are necessary to allow Surety Mutual to compete and survive.

5. That the management of the company possesses the necessary competence and integrity to reasonably manage the affairs of the company.

6. That the demutualization is in the best interest of the eligible members.

7. That Surety Mutual has satisfied the requirements of N.D. Cent. Code § 26.1-12-32 and N.D. Admin. Code Chapter 45-03-21.

8. That the proposed demutualization of Surety Mutual and the sale of \$500,000 of stock to Duane Steffes be approved, subject to approval by the eligible members.

9. That the proposed distribution of cash to the eligible members in return for the relinquishment of their voting rights and in recognition of their contribution to surplus is fair and reasonable.

10. That no eligible member or other person has filed notice of opposition to the proposed reorganization.

RECOMMENDED ORDER

It is, therefore, recommended that the Commissioner order as follows:

IT IS ORDERED the proposed reorganization of Surety Mutual from a mutual company to a stock company, with \$500,000 of the stock then being purchased by Duane Steffes, is **APPROVED** subject to approval by the eligible members and subject to receiving a contribution to surplus of an additional \$650,000 from Duane Steffes after approval by the eligible members.

DATED this 28th day of January, 2004.

Douglas L. Holloway
Deputy Commissioner
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